

TO: Files

CC: Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Councilmember Donna Frye, September 14, 2005

DATED: October 28, 2005

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On Wednesday, September 14, 2005, Michael Schachter and Sharon Blaskey met with Councilmember Donna Frye in her office to discuss wastewater issues. Also present with her was her staff member, Kevin Smith. At that time she provided us with a timeline document that she had previously drafted, and that corresponds to the set of documents she gave to the Audit Committee earlier.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Donna Frye, and constitutes protected work product. It is not nor is it intended to be a transcript of the interview.

Frye began by stating that she was elected in June 2001. She later came to draft the timeline in order to examine when the City started issuing bonds. She reminded us that she was very active in clean water issues, even before she had been elected.

Councilmember Frye discussed the chronology of her awareness of wastewater issues. There was a closed session agenda item in January 2002 in relation to what she recalls was a litigation not related to setting sewer rates. At that session the Cost of Service Study ("COSS") was raised. She had never seen it and believed it should have been a publicly available document. What she recalls of the COSS was that its purpose was to make sure rates were proportionate to use. She does not remember any discussions at that time regarding the potential loan implications.

At that closed session meeting, an action was taken to "note and file" (i.e. do nothing with) the sewer COSS. She also recalls that Mayor Murphy directed that the COSS not be released because of "harm to the industry" and because, as Frye described his rationale, it was "politically not good." She recalls pushing back on the decision not to release the COSS. She was not sure who she could talk to about the issue because it had occurred in closed session. As discussed below, she later asked for the documents and for public meetings about them.

In May 2002, in an open City Council meeting, she asked how the City was doing on the sewer COSS, and at that time she was told by the Mayor that "it didn't exist." There is a video of this discussion ("item 602"), which Frye played later for us on September 16, 2005, and of which she will provide a copy. On November 14, 2002, there was an item noticed for closed session that seemed to relate to the COSS. She wrote a letter to the City Attorney's Office

stating that she did not want to do it in closed session. She then filed a Public Records Act request. That item never did proceed as a closed session item, nor can she recall that it was ever discussed at all. Finally, in November 2002 she got the documents that show that the COSS was completed by May 2002 (when she had previously requested it).

She then came across an August 2003 letter from David McKinley, who was part of the original stakeholder's group on the wastewater issue. The letter references tabling the study indefinitely. Until this point she did not know about "these guys" [presumably Kelco/ISP, of which David McKinley is a representative]. She does not recall how she got the letter, but believes someone brought it to her. She recalls her reaction that the letter was "a bit of a shock" and "rather enlightening to her world view." Seeing the letter was when the "pieces of the puzzle came together." She does not recall when she received it, but it was sometime after the date that it bears.

On October 17, 2003, Frye finally got the "final" COSS. She also got the water COSS. She said that the documents were made public. She also clarified that the draft had to be redone because the numbers were so outdated, and she cites redoing the study as the mechanism by which "they kept [her] at bay for another year."

On February 11, 2004, the letter from the SWRCB (dated 11/26/03 and discussing the City's non-compliance with loan covenants) was handed to her. This moment represented "the collision" of the bond and clean water world to her. Upon reading the letter she believed that this was a liability that should have been disclosed. At that time, she asked Mike Uberuaga if the liability had been disclosed. He told her it had not been, and she said, "It needs to be." Prior to February 2004, she never had any conversations regarding disclosure of the non-compliance. Once she raised the issue with Uberuaga, she recalls the following day Mendes came to speak to her and they discussed the need to disclose. She thinks these separate instances were the first times she talked to either Uberuaga or Mendes respectively about the need to disclose this non-compliance. She does not think she asked them whether *they* had previously discussed the need to disclose the non-compliance.

It was this same week that she learned of the 11/26/03 letter that she also learned that Maco was hired and the SEC was doing an investigation. This stands out in her mind because Maco was introduced earlier that week in closed session, without explanation, and she later had to learn of the break of the pension events by reading the Union Tribune (rather than being personally notified by the City). The Voluntary Disclosure was made shortly thereafter, on March 26, 2004.

Frye concluded her oral chronology by stating that the City finally did adopt the appropriate rates, and now it is being sued. She summarized the series of wastewater events in that her initial focus was to make sure everyone was paying their fair share. She subsequently had different levels of epiphanies. The process was marked with frustration for her in that she knew the COSS was a public document but she did not know how to make it one, because she first learned of it in closed session. A determinative factor of whether an item can be presented in closed session is whether that item is in the public interest. Frye could not recall what the particular closed session item was that sparked the initial discussion of the COSS, and said she would need to go back and find the closed session documents. Specifically, she could not recall

whether the documents pertained to the COSS or Prop 218. She recalls that the reason that she was given for needing to address the COSS in closed session was that politically, the Mayor did not want to raise the rates of big corporations and businesses. She said that according to the Mayor, they would not release the COSS "until they force us to." She thought this response was not proper because she could not understand how you could refuse to release a public document. Of Kelco, Frye said that she was not familiar with their history of campaign contribution. She said they "create good, high paying jobs," but otherwise does not know why Murphy would have wanted to keep the COSS quiet.

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